

VIA ELECTRONIC MAIL AND OVERNIGHT EXPRESS

December 20, 2001

Mr. Rock Regan
President
National Association of State Chief Information Officers
167 W. Main Street, Suite 600
Lexington, Kentucky 40507-1324

Re: Issues Raised in November 15, 2001, NASCIO Conference Call Regarding
Microsoft Licensing Programs and Terms

Dear Mr. Regan:

Thank you for the opportunity to participate in the November 15 conference call with the NASCIO member states and for the summary of those discussions in your December 6 letter. We appreciate this opportunity to provide more thorough and concise responses to the important issues raised during the conference call. Attachment A to this letter provides our formal responses to the specific issues identified by members of NASCIO. We are pleased that many of the states' concerns are already addressed in our current 6.0 volume licensing programs and terms as discussed in detail in Attachment A.

We invite NASCIO's careful consideration of these responses and would appreciate the opportunity to continue the dialogue with NASCIO members on these and other matters important to the states. As mentioned in the conference call, we would also be pleased to broaden the discussion to other issues regarding Microsoft products and services.

In developing our state and local government licensing programs and terms, and therefore the attached responses, we took the following into consideration:

1. Our government licensing programs and terms are based on their commercial counterparts. It is our experience that governments generally embrace commercial programs and terms as a key means to ensure fair and equitable treatment;
2. To the extent there are licensing or other procurement issues unique to governments and generally applicable to all governments, we make every effort to address those issues in appropriate ways in customized government form licensing agreements based on the commercial versions. For example, our State & Local licensing agreements address the following items in a manner we have found generally acceptable to states: definition of entities eligible to purchase under the agreement, applicable law, non-appropriation of funds; public records

requirements; and sovereign immunity/anti-deficiency. We attempt to address on a case-by-case basis those issues unique to some, but not all states;

3. As a matter of state sovereignty, we recognize that state laws supersede our contract terms and we are responsible for knowledge of and compliance with applicable laws. We distinguish, however, agency policies, procedures, and terms – which though often based on a statutory requirement, are not themselves “law”, and are therefore negotiable;
4. We continually benchmark our licensing programs and terms against competitive offerings and believe we are in the mainstream if not progressive in most areas;
5. We are prepared to negotiate and be flexible, but are mindful that government contracts are public records setting highly visible precedents for other customers - commercial and government; and
6. Simplification of licensing programs and terms is an ongoing effort at Microsoft. However, some complexity inevitably flows from the desire to provide greater flexibility and consistency to the maximum number of customers worldwide. In this regard, we have no assurance the issues raised by individual states - and their desired changes - are shared by all states, and to that extent we are constrained in proposing programmatic changes suitable to all states. However, we would be pleased to work with NASCIO to identify and address in a programmatic way issues in addition to those identified in paragraph 2, above, which are unique to governments and which we can address for all states in a consistent fashion.

In the spirit of continued collaboration, we would like to invite NASCIO to assign a representative member to participate in our worldwide customer licensing council that is designed to provide feedback on program design ideas for worldwide licensing and pricing. The customer licensing council puts us in touch with a diverse set of customers representing various software procurement needs. We will be forming the next council after the first of the year and typical councils last for one year. We ask that the NASCIO representative bring candid feedback to Microsoft regarding issues generic to state and local governments in the form of regular conference calls and occasional visits to Microsoft.

We are in the planning stages for the next council, but this seems like a perfect opportunity to institute a strategic relationship with NASCIO. We believe your active participation in our licensing council will benefit our design process. If participation on the council is of interest to NASCIO, we will forward the details of the next customer meeting early in the new year to your designated representative.

Finally, we noticed that many of your issues involve ensuring predictability in software procurement and deployment. One of the primary benefits of our Enterprise Agreement program and Software Assurance offering is to bring predictability to the license process so that organizations can avoid unmanaged product diversity, achieve standardization of

software through easy license tracking and management, and avoid the financial spikes associated with staggered product release schedules through scheduled payment options. We are confident states will benefit from the simplicity and predictability of our licensing programs in the long-term.

Please feel free to call me at any time to discuss next steps. We are anxious to continue the momentum generated by this important dialogue.

Sincerely,

Kathryn Mihalich
on behalf of Pete Hayes

Attachments:

- A. Microsoft Formal Response to Issues Raised in November 15, 2001, NASCIO Conference Call
- B. Microsoft Select Agreement – State & Local (Version 6.0, October 1, 2001)
- C. Microsoft Enterprise Agreement – State & Local (Version 6.0, October 1, 2001)

cc: Mary Gay Whitmer, NASCIO Government Issues Coordinator
William Landefeld, Vice President, Microsoft Worldwide Licensing Programs
Frank Giebutowski, General Manager, Microsoft State & Local Government Sales
Kathryn Mihalich, Manager, Microsoft Government Business Desk

ATTACHMENT A

FORMAL MICROSOFT RESPONSES TO ISSUES RAISED IN NOVEMBER 15, 2001, NASCIO CONFERENCE CALL

Note: In reviewing these response, Section references are to provisions in the (1) Microsoft Select Agreement – State & Local (version 6.0, October 1, 2001), attached as Attachment B; and/or (2) Microsoft Enterprise Agreement – State and Local (version 6.0, October 1, 2001), attached as Attachment C.

ISSUE 1: Defining What is Included in Maintenance

Concerns as Presented by the State of Connecticut's Alan Treiber

- Traditionally, bug fixes and service packs have been treated as a license right. The end user licensing agreement does not refer to bug fixes and service packs.

Microsoft's product warranty (Select, Section 13; EA, Section 14) states that the product will perform to the specifications described in user documentation. The warranty in our license agreement is fulfilled by providing bug fixes and service packs. Nothing in the 6.0 licensing program diminishes or affects states' access to service packs and bug fixes made generally available to all customers as compared to prior licensing programs.

End users may access sites such as <http://windowsupdate.microsoft.com> and <http://office.microsoft.com/ProductUpdates> where updates and fixes are automatically downloaded to their desktops. Other products groups make their service packs available on their respective web pages. Licensed entities, including state governments, also get these service packs in the CD kits they receive from us.

- Where are a state customer's rights to service packs, hot fixes and bug fixes defined? Could we include service packs and bug fixes as a license right that is contained in a standard contract term that does not have to be negotiated? Do Software Assurance and/or Software Assurance Membership include service packs, bug fixes or hot fixes?

Microsoft commits to the warranty provisions contained in the volume license agreements. Service packs are a vehicle to meet those warranty provisions. Software Assurance Membership includes these same warranties since Software Assurance is upgrade coverage for the underlying licenses that have our warranty support.

ISSUE 2: The Affordability of Maintenance (Changing from Upgrade Advantage to Software Assurance)

Concerns as Presented by the State of Arizona's Lisa Dee Meyerson

- Some state budget cycles require 1 ½ to 2 ½ years of planning. These states may not be able to take advantage of the grace period for changing from Upgrade Advantage. This also raises questions about the value of Software Assurance.

As for the biennial legislature and budget cycle issues, we acknowledge this is a situation unique to certain states and are prepared to work, on a case-by-case basis, with those states where the timing of the meeting of the biennial legislature did not allow adequate lead time to appropriate funds to accommodate changes in the 6.0 licensing program. However, we anticipate that this should be an issue in few states, because the extension of the launch period, plus the availability of two years of Upgrade Advantage, provides states with in excess of three years to make informed decisions regarding Software Assurance. Based on feedback from IT managers around the world, we designed Software Assurance to bring predictability of software costs to avoid the financial spikes associated with one-time upgrades. By knowing if computers are covered and licensed properly, the IT manager can better manage and track the organization's licenses.

- States may find it burdensome to pay for Software Assurance at the time of the purchase of a new license or during the grace period if they do not have additional funds available for the purchase of Software Assurance.

We understand that software acquisition costs is a critical decision factor for state agencies and the importance of maximizing the value of each software purchase when spending taxpayer funds. For this reason, we offer the ability to spread out payments over a 3-year period with our Enterprise Agreement program and now, under Licensing 6.0, we are offering this financing to our Select 6.0 Software Assurance customers as well. Both Select and EA customers may spread out the cost of their initial purchase over the life of their contract and make annual payments to Microsoft at no extra charge. Not only is this financing helpful in planning and requisitioning budgets, it offers the IT manager a practical method of administering the organization's licenses in the long-term.

- Microsoft's maintenance fees are considerably higher than the version upgrades and the industry standard, which can create an immediate budget impact for states in times of economic downturn.

The cost to a customer for Microsoft product license is often less than the license cost for a competitive product. As a result, the maintenance (Software Assurance) cost, expressed as a percentage of the license cost, will often be higher for Microsoft products than for its competitors. However, in absolute dollars, the maintenance cost, and the maintenance cost plus the license cost, are competitive with offerings from other vendors (and in many cases the total of the license and maintenance costs are significantly less than competitive offerings).

- Only customers with an Enterprise Agreement can have Premier Support.

On May 10th 2001, we announced that in 2003, only Software Assurance Membership or Enterprise Agreement customers were going to be able to obtain Premier Support since

we wanted to make sure that our customers had rights to the latest software in order to provide them with the best support. However, based on feedback from customers, we announced in September 2001, that Premier support will be available to all customers and that a new, higher level of Microsoft support will be available to our Software Assurance Membership customers in the summer of 2002. Our partners will also continue to offer product support.

- The states would like the following (1) an ability to pay for back or lapsed maintenance (2) bringing maintenance prices more in line with the industry standard and/or providing additional technical support (3) softening of Premier Support requirements, possibly tying them to products that are on Software Assurance (4) more predictability with budgeting for licenses and maintenance and (5) provisions in government contracts to cap increases during the term of the contract.

Because Software Assurance upgrade coverage is a reasonable percentage of the full license price (given that a customer receives the right to all upgrades during the period of coverage), we require that customers have the latest version of the license in order to qualify for this pricing. Customers have two upgrade options going forward: (i) buy the full license or (ii) buy the license and Software Assurance package. If Software Assurance coverage lapses, customers are required to buy the full license in order to qualify for the Software Assurance pricing.

We have calculated Software Assurance pricing based on the value of providing upgrades over the 12 month period and the costs to Microsoft of creating software. The pricing of Software Assurance is actually less than what Microsoft charges for Upgrade Advantage coverage.

Premier support coverage was made available only with Software Assurance coverage in our May 10, 2001, announcement, but this requirement was rescinded in September 2001, as mentioned above. We plan to offer a new, higher level of product support in the summer of 2002 for Software Assurance Members exclusively. We plan to announcing more details later.

Feedback from customers was a key factor in the development and launch of the Software Assurance program. Customers emphasized the difficulty of managing software purchases with so many upgrade options available. As a result, we eliminated the confusing array of upgrade options offered in the past known as the VUPs, CUPs, PUPs, etc and replaced them with Software Assurance. Software Assurance is an easy way to track and manage software licenses.

In what we view as a significant customer benefit, under the Enterprise Agreement and the Software Assurance component of the Select Agreement: (i) reference pricing is fixed for the initial term of the enrollment, and (ii) a three-year financing option is available.. Future acquisitions will be at the then-current license reference prices. We commit in our Select (Section 6) and Enterprise (Section 7) Agreements not to impose changes to

product use rights during the version of a product. This provides another element of predictability in the license acquisition and management process.

ISSUE 3: Disparity in Pricing Levels Between Large and Small States

State Concerns as Presented by the State of New Hampshire's Leslie Mason

- Microsoft should consider eliminating the disparity in pricing levels between large and small states. About 15 states have expressed this concern.
- One option would be to eliminate levels in the Select Agreement, as is the case with academic agreements, to allow for more equitability in discounts.
- Microsoft should allow aggregated purchasing on a regional basis.
- Consistent discount terms and conditions need to be implemented among the states more equally. There are indications that terms and conditions seem to be negotiated on a case-by-case basis. Long-term negotiations cost states money.
- Small states with Select Agreements have difficulty meeting Select Agreement quotas each year.

Microsoft's volume licensing model is based on certain concepts:

- 1. consistently-applied program rules and terms and conditions;*
- 2. price discounting (or more precisely estimated reference price (ERP) discounting) based on volume of licenses purchased by identifiable legal entities; and*
- 3. a contractual and operational framework that assures Microsoft can track licenses granted to end user entities – to ensure accurate and timely delivery of software media, updates, services paks, etc. and other customer support activities, and to provide Microsoft the necessary legal relationships to protect its intellectual property.*

The issues raised by the states strike at the heart of one or more of these fundamental concepts. While we have encountered the notion of “aggregated” buying among unaffiliated entities in the past, and are prepared to continue the dialogue on this topic, we are not currently prepared to adopt this approach for several reasons:

- 1. volume discounts are fair, equitable, and objectively verifiable;*
- 2. the framework or rules for volume licensing discounting becomes susceptible to erosion from all directions as entities of all types seek to aggregate;*
- 3. large entities entitled to volume discounts under the traditional rules are likely to seek even higher discounts; and*
- 4. under sovereign immunity principles as Microsoft understands them, no state can execute a contract on behalf of another, or assume responsibility for intellectual property compliance by another state. Thus, we have not identified a practical way to construct a contract among unaffiliated entities that will adequately protect Microsoft's intellectual property rights in its products and services.*

Ms. Mason indicates in her November 14, 2001, memo, that other software companies allow purchase aggregation on a regional basis. We would be interested in learning more about if and how those aggregation agreements are structured in a manner consistent with the fundamental concepts identified above.

Issue 4: Express Split Payments of Upgrade Advantage

State Concerns as Presented by the State of Indiana's Jeanne Corder

- Split payments are needed by states with budgeting constraints. Unless expressed in writing, some states may not be able to take advantage of Microsoft's offerings.
- There are no alternatives for states unable to split payments. There is no way to upgrade for another three years.

Generally, actual price and payment terms are a matter between a state and its chosen reseller. Moreover, installment payments in Select and Enterprise Agreements are already a form of financing of a customer's product license fees. In any event, on a case-by-case exception basis where state funding issues are involved, Microsoft can facilitate split payments with an appropriate cost of money factor included in the reference pricing on the deferred amounts.

ISSUE 5: Non-Appropriation Clauses

State Concerns as Presented by the State of Wisconsin's Scott Holt

- With budgets locked in place for two years, states need a lot of lead-time for budgeting. Short notice of changes in upgrade programs gives states two options: (1) to not purchase upgrades or (2) to significantly scale back upgrade purchases.

As for the biennial legislature issue, we acknowledge this is a situation unique to certain states and are prepared to work, on a case-by-case basis, with those states where the timing of the meeting of the biennial legislature did not allow adequate lead time to appropriate funds to accommodate changes in the 6.0 licensing program. We hope that our decision to extend the availability of Upgrade Advantage has helped alleviate this concern for some states.

- All state government contracts need non-appropriation language. State legislatures are not bound by state agency contracts, and state agencies do not have control over legislative appropriations. Another clause all state government contracts need is that the contracting state's law will govern the contract. States would like to see a consistent platform through which Microsoft recognizes that state governments are going to need certain terms in all contracts.

Microsoft appreciates the statutory requirements of the states' appropriation processes and accounts for it in its form agreements with state customers (See Select, Sections 3b, and 10; EA, Sections 6 and 11). Under Select, a state has the option to pay for Software Assurance or License and Software Assurance in a lump sum or in installments. Where it elects to pay in installments, i.e., across appropriation cycles, but funds are not

appropriated to pay future installments, the affected enrollment may be terminated without penalty to the state and the state is entitled to licenses proportional to installment amounts paid. The Enterprise Agreement takes essentially an identical approach to the non-appropriation issue, except that it assumes all products are paid for on an installment basis. We acknowledge state laws will govern to the extent our agreement forms do not adequately accommodate those laws. The issues we know that are unique to government, but common to all states, are already addressed in our current 6.0 volume licensing programs.

ISSUE 6: Re-imaging Rights

State Concerns as Presented by the State of Wisconsin's Judi Werner

- Reports indicate that product activation codes require each installation of Office and Windows to be registered. Once activated, installations may not be moved without contacting Microsoft.

We protect our software from multiple installations if purchased through the retail channels. Because the main benefit of volume licensing is the right to make multiple copies of our products across a government agency or across the entire state government, we provide a volume license product key that allows for the making of multiple copies. Product activation keys do not affect a volume license customer's right or ability to make all copies it desires to license, but are useful tools to protect Microsoft from software piracy.

ISSUE 7: Lock-In Product Use Rights

State Concerns as Presented by the State of Arizona's Lisa Dee Meyerson

- Microsoft can unilaterally change product use rights. States would like an agreement that will prevent product use right decreases but will allow for increases.

To address this concern, we indicate in both the Select (Section 6) and Enterprise (Section 7) Agreements that we will not change product use rights unless we release a new version of a product. Furthermore, we agree in the Enterprise Agreement not to change use rights for the term of the contract for key Microsoft products: Windows, Office and the Core CAL. This commitment on use rights is our way of rewarding our most loyal customers and helping them manage their licenses. Under the current scheme, product use rights are set at the time of enrollment. For products or versions introduced after enrollment effective date, the product use rights are set at the time the product or version first becomes available.

- It is difficult to determine the product use rights, when many state agencies are enrolling at different times. States would like more predictability with product use rights.

We understand the complexity involved with so many different departments within a large state government. We have committed not to change use rights in a product mid cycle

release and we have locked them down for certain enterprise products in the Enterprise Agreement as mentioned above. Microsoft has a broad range of products that have different release lifecycles and during the term of one customer's volume license agreement, we cannot predict what products will be released and what new technology will be available. This is both a challenge and a benefit of the software industry. This is a key reason why having Software Assurance coverage is beneficial for states. With Software Assurance, states are assured of rights to the latest software with no more financial spikes associated with future version releases.

ISSUE 8: Amending Audit Clauses To Provide Additional User Protections

State Concerns as Presented by the Commonwealth of Massachusetts' Marge MacEvitt

- A standard term in Microsoft agreements requires that, when an audit reveals a state's license shortage of 5% or more, then the state must remedy the shortage by buying additional licenses from retailers. States want a standard term in Microsoft contracts that will allow them to buy these additional licenses at the Select Agreement price.

Microsoft has made certain pro-customer enhancements in the "audit" clause over the years, e.g. longer notice periods and a less-intrusive self audit alternative. The fundamental purposes of the audit clause, however, are to provide a mechanism to validate accurate and complete license reporting and usage and a reasonable incentive for customers to comply in a timely fashion. Allowing customer to pay for material non-compliance simply at the contract price removes any contractual incentive to comply and, in that sense, would render the provision ineffective.

Enforcement of the material non-compliance provision against governments has historically been a highly remote possibility, but the "incentive" to comply is an important one and, in our view, quite reasonable under the circumstances.

- Most states have stringent Executive Orders in place against software piracy.

We appreciate the efforts of many states in the issuing anti-piracy executive orders and would be willing to assist other states in launching anti-piracy campaigns. Monitoring and enforcement of executive orders is a difficult challenge that requires the concerted efforts of governments and software vendors. We are committed to help in these efforts wherever and however we can. In our view, government credibility in this area is greatly enhanced where government customers, in their public record agreements, commit to the same limited audit requirements as Microsoft requests of its commercial customers.

ISSUE 9: Customization Of Definitions Of Desktop Or Employee

State Concerns as Presented by Wisconsin's Scott Holt

- Home Use Rights historically have been available in prior agreements. Now, they are not part of the agreements or are added in at additional cost, which has increased the cost to states dramatically. This is especially important for employees needing a laptop for remote use only. States want these rights reintroduced.

We have tried to address the need of state governments to allow their employees the flexibility to work remotely as well as balance the need to ensure that retail businesses in a specific state have the ability to sell a product to the end user at a competitive price. For several years now, we have offered “Work At Home” licenses for organizations that wish to offer at home use for their employees. These licenses are available on the Select price list. Additionally, there are certain portable use rights which allow for the primary user of the licensed desktop to make a secondary copy for his or her exclusive use on a portable computer, as further described in the product use rights. For some server products, we have remote use licenses as well.

- Federal law mandates that states purchase software for those in employment rehabilitation or workforce development programs. Although states do not govern this software once purchased, they want the agreements to include licenses for this.

We are aware that states offer a variety of unique programs involving software licenses to their constituents, often under federal or state mandates. We are prepared to work with states on a case-by-case basis to reasonably address the requirements of such programs.

- States would like to purchase software for outsourcers.

To address certain outsourcer situations, we have prepared a customized outsourcer enrollment form which allows an outsourcer to submit an enrollment under a state’s volume licensing agreement with the understanding that (i) the outsourcer may use the licenses during the term of the outsourcer relationship for the sole benefit of the state; and (ii) such licenses transfer to the state upon expiration or termination of the outsourcer relationship. We are prepared to consider other outsourcer relationships on a case-by-case basis.

- States need assistance in calculating their total number of licenses for desktops. For employees with a desktop and a laptop for remote use, should there be one or two licenses?

This question depends on whether a state is doing calculations under an Enterprise Agreement in which case the definition of “qualified desktop” applies, or for individual products, in which case the individual product use rights govern these circumstances. Our channel partners and Government Licensing Executives can assist you in these calculations.

Microsoft’s Response to State Concerns:

ISSUE 10: Identifying Department Or Agency On License Confirmations

State Concerns as Presented by Hawaii's Marc Yamamoto

- Currently, individual agency and department licenses do not specify the ordering agency or department. This information is available as part of LAR's client information and could be easily accessed by Microsoft. This information should be included on the individual licenses.
- Including all agencies and departments within the Master Licensing Agreement is not feasible, as many agencies cannot meet the minimum 500 unit requirement.

Our internal processes can report and track licenses at the enrollment level. To address state's desire for more detailed data, we are prepared to accept multiple, separate qualifying enrollment. The 6.0 Enterprise Agreement minimum requirement is 250 qualified desktops per enrollment. Some states, however, specifically require consolidated enrollments, which will limit the availability of individual enrolled affiliate data.

ISSUE 11: Legal Issues (Warranty of Title, Indemnification & Statutory Damages)

State Concerns as Presented by the State of Colorado's Valerie McNevin

- States are concerned that Microsoft has a product for which it cannot warrant title. This concern has increased in light of recent security-related issues and HIPAA implementation.
- There is a concern over what entities are covered under the agreements (for example, localities and municipalities). An East-West divide exists on this issue. Eastern states have more control over their municipalities than do Western states. Western states also cannot indemnify entities other than the executive branch.
- Microsoft wants the states to indemnify it, but does not indemnify the states in return or restricts its indemnification of the states. This is problematic concerning potential infringement suits. Without warranty of title from the vendor, a state may be liable in an infringement suits.
- Regarding statutory damages, states do not want to be liable for infringement but they are not getting warranty of title or indemnification.
- A number of states have requirements relating to these concerns in their statutes. These requirements must be contained in contractual terms and conditions. Microsoft needs to make it so states can comply with these statutory requirements.

Here are our responses to the various issues we understand as being raised by the state concerns. If we have not fully understood the issues, and therefore, not adequately responded, we would be happy to discuss further.

1. *Microsoft licenses software. It does not transfer title, i.e. ownership, in its software to its customers. Because we do not transfer title, we are careful not to warrant title because we want to avoid any possibility that the warranty of title could be construed as acknowledgement of transfer of title. We are unclear how this impacts security or HIPPA issues but are happy to explore any "work around" that satisfies the concerns of Microsoft and states in these situations.*

2. *We recognize that sovereign immunity and other statutory provisions impact the ability of certain states to contract for, and assume liability on behalf, of local governments, and vice versa. We are prepared to accommodate this concern in a couple of ways: (a) accept product enrollments (assuming a minimum of 250 qualified desktops in the case of an Enterprise Enrollment) from individual state and local agencies, or multiple agencies, at the state's election; and (2) insert into our state and local program agreements the following provision: "Each enrolled affiliate will only be responsible for its compliance, and the compliance of its authorized sublicensees, with the terms of this agreement and the enrollment(s) under which it licenses Microsoft products". Because an enrollment incorporates and is subject to the applicable program agreement (Select or Enterprise), this additional clause will make clear that state and local entities not participating under an enrollment, will have no responsibility whatsoever for compliance with the terms of that enrollment.*
3. *Microsoft does in fact defend states for patent and copyright claims (Select, Section 14; EA, Section 15) in a manner we believe is consistent with competitive offerings. It is unclear how a state is at greater risk for an infringement suit if Microsoft does not provide a warranty of title to state. In some states, the mere filing of such third party claim against the state may be prohibited.*
4. *We are unclear of your connection between statutory damages, warranty of title, and indemnity in the 4th bullet and would be happy to discuss further. Our response in paragraph 3, above, addresses some of these concerns. With regard to statutory damages specifically, if states have statutes which impose potential damages on Microsoft in addition to or different than those specified in the limitation of liability provision of our agreements (Select, Section 15; EA, Section 16), the statutory provision(s) will apply (assuming the statute prohibits state and vendors from varying the terms of the statute by contract). Though it is not legally required (statutes control over conflicting contract provisions in any event), our limitation of liability provisions expressly recognizes this reality by stating "to the maximum extent permitted by applicable law". Applicable law, in each case, is the law of the state entering an agreement with Microsoft (Select, Section 17k; EA, Section 18k).*
5. *In sum, we acknowledge the primacy of state statutes over our contract terms and our responsibility to be knowledgeable of and comply with applicable law. For that reason, we generally consider it inefficient for both parties to expend substantial effort incorporating various statutory provisions into our contracts. Those statutory requirements that we know are unique to governments, and generally applicable to all governments, we have already addressed in our form agreements, i.e. definition of state "affiliates" eligible to purchase under the state agreement (Select, Section 1; EA, Section 1), public record laws (Select, Section 12; EA, Section 13), non-appropriation (Select, Section 10; EA, Section 11), applicable law (Select, Section 17k; EA Section 18k), sovereign immunity/anti-deficiency (Select, Section 17l; EA, Section 18l, and various provisions where*

states do not have indemnity obligations that commercial customers do). We are, in all cases, prepared to work with states to assist them in complying with their statutory obligations.

ISSUE 12: Other Issues Raised In The Question And Answer Session

1. Whether Microsoft calculates its average upgrade cycles across all customer bases:

Microsoft generally calculates its average upgrade cycles across all customer bases and not by specific industry to ensure that we do not bias our pricing toward a specific segment. However, we do make some specific average upgrade cycle calculations in relation to small and large organizations.

Microsoft looks at pricing and licensing in a comprehensive way to take into account all of its customer segments. There is always a trade-off between choice/flexibility and simplicity/equitable terms and conditions.

2. Niche market terms and conditions in software agreements are important as Microsoft moves into an enterprise space. Should Microsoft cater more specifically to the needs of government? Other vendors provide specific items, such as perpetual licenses, discounts, and upfront pricing and maintenance levels, to government.

We agree and, as a result, have dedicated government sales and licensing teams focused on each state and its unique concerns, and customized government licensing agreements to address general issues unique to governments in a framework consistent with those terms offered to commercial customers. After a state has had a chance to review the responses in this document and the Select and Enterprise Agreements, and conduct a business analysis to see if Software Assurance is beneficial to it, we would be pleased to work with the state toward a mutually agreeable licensing solution.

ATTACHMENT B

MICROSOFT SELECT AGREEMENT – STATE AND LOCAL
(Version 6.0, October 1, 2001)

ATTACHMENT C

MICROSOFT ENTERPRISE AGREEMENT – STATE AND LOCAL
(Version 6.0, October 1, 2001)